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LOOKING AT LABOR: WORKFORCE ANALYTICS IN M&A TRANSACTIONS

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WORKFORCE ANALYTICS IN M&A TRANSACTIONS

Despite the volatility and uncertainty of today's global economy, organizations keep looking ahead, and many of them are heavily engaged in M&A activity. But what have they learned from the excesses and recessionary consequences of the last decade? If anything, they must be more focused than ever on adding complementary opportunities to their core business portfolios, with an unerring eye on the human-capital implications that can determine their ultimate return on investment.

Indeed, the talent being acquired is often the key factor that can deliver on or undermine the ROI of a deal. To optimize the ROI, a human-capital risk review should be undertaken, focused on more than just the cost of employment (such as compensation and benefits) and the elimination of redundancies. In addition, companies should consider the value of the human-capital-asset and the practices and policies in place to support it. Increasingly, companies are focusing on workforce analytics to deliver on their business priorities —such analytics are also crucial in meeting today's M&A challenges.

It's worth noting, of course, that there are different kinds of deals. Some are pure asset transactions — such as those to acquire intellectual property rights or physical plants — while others bank their future financial performance on the people side of the businesses. Where it is the workforce, beyond just leaders, that drives future earnings, a focus on the human capital asset can make the difference. For many acquiring companies, the link between the workforce and future success is too simplistic — it is made by gauging historic revenue per employee, assuming and setting improvements in productivity, and settling on a required number of workers.

This budget-driven approach to managing just headcount may be attractively straightforward, but its simplicity fails to account for the human capital drivers of ultimate financial success. For a human-capital intensive enterprise, a more appropriate evaluation will require a more complex understanding of the target organization's internal labor market (ILM) — that is, the processes by which that organization obtains, develops, rewards, and retains its talent and, given those processes, how its talent performs.

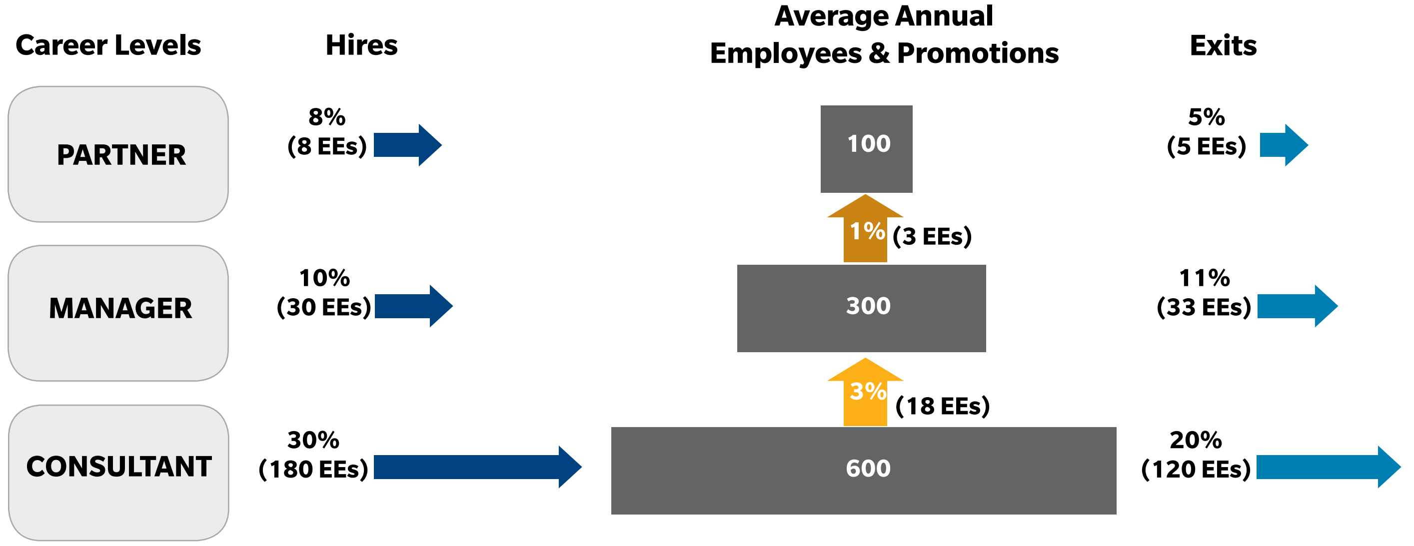
ILM talent "flows" reveal how desired results of the deal can be achieved through changes in HR decisions, policies, and practices after the deal closes; it can also reveal the true sources of value that support the organization. Specifically, examination of these flows will show relative focus on buying versus building talent, developmental bottlenecks, dependencies on the external labor market for filling critical roles, and retention pain points, as well as alignments/misalignments in practices, including hiring profiles, pay-for-performance, and training programs, any of which can argue for or against a deal moving forward. In the case of a merger, differences in such practices between organizations that must come together to realize desired synergies need to be addressed before going ahead.

A CASE IN POINT

A private equity firm was considering the acquisition of a specialized consultancy. In mapping out the organization's ILM, the firm discovered that the target had a near-exclusive dependency on buying rather than building talent and, not surprisingly, a lack of internal development processes for its hires. Few hires ever moved up, and most left with only a few years of service. The target's internal labor market is represented below, though it is masked to protect its identity.

Note: An internal labor market map shows average active headcount by career level in the central bars, as well as hires, promotions, and exits from each level. Here, an emphasis on buying over building talent is very clear, and contrasts with an anticipated human capital model of developing talent to promulgate company-specific processes.

INTERNAL LABOR MARKET MAP



All percentages shown are calculated based on the average annual headcount within each level. Support staff omitted.

The firm was essentially an affiliated network of independent sellers and producers, each recruited to do what they had learned to do elsewhere and each heavily compensated for their own connections and ability to generate work — a far cry from the firm's widely touted view of itself as an innovator of market-leading intellectual capital and consulting processes that drove its value proposition to the marketplace. How can such a differentiating "product" be leveraged in an organization that doesn't develop its people to learn, adopt, and promote that product? Further examination revealed little formal infrastructure for learning and development.

When continued investigation of practices showed only an immature talent acquisition model, the potential value of the firm's recruiting strategy also came into question: Could the acquirer hire similar quality talent and drive similar value to the market by "hanging up a shingle"? Indeed, investigation of available labor in the relevant external talent markets showed ample availability of required talent.

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Ultimately, given the identified talent risks and their link to what no longer seemed to be a unique value proposition for the firm, the deal did not proceed.

A ROBUST APPROACH

To review human capital risk in the context of an acquisition, the following three-step approach can be pursued in the due diligence and/or integration phases of a deal:

1. **Understand talent SUPPLY: ILM flows and other views of the current workforce depict how an organization manages its "supply" of human capital and can identify areas of risk (for example, developmental bottlenecks, turnover hot spots, and rewards misalignments supporting suboptimal behaviors). This data analysis can be instantly revealing, as when examination of the age distribution of critical employees shows a large number due to retire within a few years. Recent flows and workforce demographics can also serve as the basis for future-oriented labor force projections, by occupation or business area.**

2. **Consider talent DEMAND: Projections of the future workforce need to be evaluated against workforce requirements. The acquirer needs to determine what occupations are most critical to the realization of the deal's objectives — for example, sales managers in key locations, senior researchers in R&D, and master technicians in the firm's manufacturing plants. Assess how many people are needed to operate — and grow — the business effectively; that is, how the people requirements break down by business line, function, or level. Company management should know the implications of its business strategy for talent requirements over the next three to five years, and targeted executive sensing can provide crucial insights.**

3. **Consider what it would take to close identified GAPS: In reconciling "supply and demand," the acquirer can assess to what extent the workforce will deliver on objectives and consider strategies to close gaps. An examination of external labor market data on available workers with required skills in geographies of current and future operations can clarify hiring opportunities and help to address issues. Statistical models on workforce data can highlight those specific interventions (for example, compensation changes, training programs, and recruiting profiles) that would have the greatest potential, in a given environment, to accelerate talent development and/or improve the retention of critical talent.**

In assessing the state of the target company's workforce using the above approach, the main challenge is often a lack of access to comprehensive data. However, it is often possible to leverage typically available employee census data, which would include employees' hire dates, job titles, locations, etc., on the supply side of the analysis, against seller financial forecasts and/or responses to questions during management presentations on the demand side. Obviously, it's sensible to request more extensive data up front and press for its provision; data is rarely unavailable in company systems.

Once future talent gaps within critical workforce segments have been identified and prioritized, it remains for the company to consider what HR policies are driving current problems and what can be changed to reduce or mitigate gaps and any associated financial under-performance. A carefully constructed statistical model can make the case. For one financial services company, retention was not impacted by large bonuses paid out — pointing to potential for repositioning significant budgets with greater effect. Employees were, in fact, most likely to leave in response to supervisory changes generated by a system of incessant transfers; the critical intervention for this company was to institute a minimum time-in-job requirement coupled with greater supervisory training.

Ultimately, and as we've shown here, the challenge of ensuring a required ROI in today's increasingly demanding M&A environment can be met by a rigorous assessment of human-capital risk, made possible by the new science of workforce analytics. Utilized carefully, the strategic advantage this offers can spell the difference between deal value that founders amidst unexpected workforce consequences and a deal that pays off for the long term.

> "ROI can be met by a rigorous assessment of human-capital risk, made possible by the new science of workforce analytics."

ABOUT THE AUTHORS

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